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UNCLAS SECTION 01 OF 02 LAGOS 001100

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TAGS: ECON EFIN EPET ETRD ECPS NI
SUBJECT: NIGERIA: STATE OF THE ECONOMY FOR JUNE/JULY 2005, OUTLOOK FOR FALL

¶1. Summary: Nigerian economists indicate that the country can expect continued inflationary pressure, increased interest rates, and modest naira depreciation. This economic environment will cause Nigerian investors to continue to look outward for investment opportunities, as evidenced by a 30% increase in foreign exchange investments in June. The Nigerian stock market, however, is still attracting investors, and new capital requirements for banks set for December 2005 have resulted in increased trading levels. Current trading suggests that more banks than previously thought will survive the need to recapitalize. End summary.

RISING INFLATION RATES

¶2. A recently released communiqu of the Central Bank of Nigeria's (CBN) monetary policy committee (MPC) estimated the monthly inflation rate for April 2005 at 16.3%. This is significantly higher than the 10.0% achieved in December 2004 and is way off the single digit inflation target set for 2005. In addition, first quarter money supply increased by 17.5%, for an annualized growth rate of 42%, more than double CBN's 2005 target of 15%. Executives at Financial Derivatives Company (FDC) Limited, a Lagos-based economic think tank, attribute the money supply saturation to the monthly release of statutory allocations to all tiers of government. They predict increased pricing pressure. For example, prices of staple foods like wheat bread have risen by about 50%.

RISING INTEREST RATES

¶3. Money market interest rates had been on a downward trend in early June because of excess liquidity in the system. However, the money market took a sharp upward turn in June to reach 14.7% by month's end, likely due to CBN's gradual withdrawal of public funds from banks. In June, the CBN withdrew approximately 30 billion naira from Nigerian National Petroleum Corporation (NNPC) and plans to withdraw another 30 billion naira in July. The CBN is concluding plans to become sole banker to seven major Nigerian parastatals, including NNPC. This move by the CBN is yet another way in which they are trying to decrease commercial banks' dependence on the government. They have already ordered state governments to reduce ownership of private banks from sometimes over 50% to a maximum of 10%, and they are closely monitoring stock market trading in bank shares to ensure that states do not overpurchase bank shares. In the past, overdependence on public funds has resulted in private banks' maintaining unsustainable debt.

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NAIRA DEPRECIATION IN JUNE REVERSES EARLIER TREND
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¶4. At the end of first half of 2005, the Naira remained stable at N132.87/$1 in the official markets, despite a marginal depreciation early June, while the value of the naira in the parallel market fell during the same period to N143/$1 from N139/$1. Many look at this difference as a result of summer travel plans, which increases demand for U.S. dollars in the parallel market without greatly affecting the official rate. Experts predict people will hold on to their U.S. dollars because of both the dollar's stability relative to the Naira and the dearth of investment outlets in the Nigerian money market. Furthermore, yields on money market instruments have become unattractive, with the MRR (Marginal Rediscount Rate) pegged at 13%, and the inflation rate projected to be 12.2% at best. Also, Nigerian government securities are currently unattractive, with Treasury bills yielding all-time low

returns of 4.5%, compared to 14.5% just a year ago.

¶5. According to FDC, the current environment is an inducement for capital flight, since investors will prefer to hold dollar-denominated assets outside of the country. "Even the most patriotic investor will think twice about investing in these money market instruments," FDC executives said. June's 30 percent increase in foreign exchange demand in the Inter-Bank Foreign Exchange Market (IFEM) to N1.07 billion (USD8.05 million) lends credibility to this assertion.

NIGERIAN STOCK: STILL ATTRACTIVE TO INVESTORS

¶6. The Nigerian Stock Exchange (NSE) remained a haven for investors, as overall price gains seemed to outweigh price losses in the first half of 2005. The NSE All-share index rose by 1.7%, while market capitalization rose by 6% from N1,860 billion in May to N1,909 billion in June.

¶7. Initial Public Offerings (IPO) for banks continued to be introduced on the floor, as smaller banks struggle to meet the December 2005 deadline to recapitalize to N25 billion. As the deadline draws closer, experts believe that, based on these IPOs, between 30 and 35 banks are likely to meet the Naira 25 billion mark, a much larger number than the 15-20 previously estimated. (Comment: The CBN nevertheless continues to investigate the origins of funds invested in these IPOs and has disqualified some. A firm estimate of surviving banks might therefore be premature at this point.) FDC executives noted a decline on returns on investment (ROI) and earnings per share (EPS) of banks that had raised capital from the NSE, despite an increase in their total earnings.

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